In the

Supreme Court of the United States

October Term, 1945.

No. 1220

RANDOLPH PHILLIPS, *et al.*, *Petitioners*,

v.

THE BALTIMORE AND OHIO RAILROAD COMPANY, *Respondent*.

No. 1221

JANE CROZIER, ROBERTA GIESECKE and HARRIET M. ACKERT, *Petitioners*,

v.

THE BALTIMORE AND OHIO RAILROAD COMPANY, *Respondent*.

BRIEF FOR RESPONDENT IN OPPOSITION TO PETITIONS FOR WRITS OF CERTIORARI

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Opinion Of Court Below

The opinion of the court below, a special court of three Judges in the District Court of the United States for the District of Maryland, is reported in 63 F. Supp. 542. The report of the Interstate Commerce Commission, containing the Commission's findings with respect to the Adjustment Plan approved and confirmed by the Decree of the special court, is reported in 261 ICC 51.

The contentions of Petitioner Phillips before the ICC were considered and overruled. The contentions of Petitioner Phillips and Petitioners Crozier, et al., in the court below were considered and overruled.

Jurisdiction

The Decree sought to be reviewed herein was entered March 13, 1946.

The proceeding was instituted below by petition filed by Respondent under the since expired[1] Chapter XV of the Bankruptcy Act (U. S. C., Tit. 11, Secs. 1200-1255) for approval of a Plan of Adjustment (PX 1; RX 1-31[2]), hereinafter called the Plan. The Decree approved and confirmed the Plan.

The jurisdiction of this Court is invoked under Sec. 745 of Chapter XV of the Bankruptcy Act (U. S. C., Tit. 11, Sec. 1245).

Statement Of The Case

The Phillips petition, No. 1220, proceeds on the theory that the Plan as approved and confirmed was unnecessary and that there was no consideration moving from the stockholders to the affected creditors, in that the "plan makes no

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[1]See *infra*, pp. 8, 11-13.

[2]The record as certified to this Court by the Clerk of the court below consists of two parts, the pages of each of which are numbered consecutively beginning with 1. One part comprises all of the documentary exhibits contained in the record. To avoid confusion, we herein refer to exhibits introduced by Respondent by reference to the numbers under which they were received and the prefix PX; similarly, we refer to the exhibits introduced by the Objector (Petitioner here) by reference to the numbers under which they were received and the prefix OX. In each case reference to the exhibit number is followed by the page number of the certified record using the prefix RX. That part of the certified record which includes the pleadings, orders of the court below, and transcript of the testimony taken before the court below is referred to by page numbers with the prefix R.

alteration of the *contractual rights* of preferred and common stockholders" (Phillips petition, p. 11; italics ours). The Crozier, Giesecke and Ackert[3] petition, No. 1221, does not question the necessity for the Plan. Rather it takes the position that there is no compensation whatsoever for the modifications of their bonds and suggests that the modification in the mortgage securing their bonds so as to permit the refunding or extension of prior lien bonds is not a proper modification under Chapter XV of the Bankruptcy Act.

Respondent's 1944 maturities, represented by notes, amounted at December 31, 1943 to approximately \$113,000,000 (PX 46; RX 1695). Its other near term maturities amounted to approximately \$218,000,000. Its funded debt securities were then selling at substantial discounts. The Refunding bonds, Respondent's only then available financing medium, were selling below 50 (PX 99; RX 2258)[4]. Upon arrival of the actual maturity date Respondent had been able to retire approximately \$29,000,000 principal amount of these 1944 maturities with treasury cash and the proceeds of a bank loan. Reconstruction Finance

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[3]To avoid confusion between Petitioners and their counsel, the petition in No. 1221 is hereinafter referred to as the Crozier petition.

[4]The Interstate Commerce Commission summed up the situation in which Respondent found itself at that time, saying: "In view of these early maturities the applicant was unable to refund its outstanding notes except as part of a general readjustment of its finances" (R. 19). The Commission also observed "From the testimony it is evident that the early maturity of approximately \$144,000,000 of first-mortgage bonds, and of an additional \$74,000,000 of other first-lien bonds within 3 years thereafter has prevented the refinancing of the applicant's matured notes, and a plan of adjustment appears to be the only means of averting bankruptcy or receivership" (R. 57).

Corporation (hereinafter called RFC), which held the balance of approximately $84,000,000, agreed to refund the same through the purchase of a new issue subject to certain conditions (PX 68; RX 1750-1). Following conferences with creditor interests, a plan of adjustment satisfactory to them and which would meet the conditions imposed by the RFC was prepared.

After securing the necessary assurances of acceptance required by Chapter XV, Respondent filed its application with the Interstate Commerce Commission for authority to issue the new securities to carry out the modifications proposed by the plan. After the hearing, the Commission, on March 12, 1945, issued its report and order (R. 11-76) authorizing the issuance of the new securities as proposed by the plan with certain minor modifications. The Commission's findings (R. 11, 63-65) are as set forth in Sec. 710(2) of the Bankruptcy Act, U.S.C., Tit. 11, Sec. 1210(2). The plan as modified by the Commission is hereinafter called the Plan.

After obtaining the necessary assents to the Plan, Respondent filed its petition for approval and confirmation. After hearing held on July 10 and 11, 1945, the court below found that the petition "complies with Chapter XV of the Bankruptcy Act, and has been filed in good faith." The court thereupon ordered that the petition be approved as properly filed and set the matter down for hearing on the merits for September 17, 1945. No petition to review the Order of July 11, 1945 (Order No. 1, R. 111) has been filed. The hearing on the merits was held on September 17-21, inclusive, and following the filing of briefs, the court below rendered its opinion on November 20, 1945, and on March 13, 1946, after hearing on the form of the Decree

and the instruments to be executed pursuant thereto, entered the Decree which Petitioners ask this Court to review. This is the fourth decision of a special three judge court under Chapter XV of the Bankruptcy Act which this Court has been requested to review on certiorari.

The Plan

The Plan, in outline, as approved and confirmed by the Decree provides for:

(1) The refunding of $84,000,000 odd of Respondent's 1944 maturities through the issuance of Collateral Trust bonds, maturing January 1, 1965, which RFC has agreed to buy, subject to the making of the other adjustments proposed by the Plan.

(2) The extension of $228,861,050 principal amount of first lien bonds maturing in 1948, 1950, 1951 and 1959 to various dates from July 1, 1975 to July 1, 1985.

(3) The making of three-fifths of the interest on Respondent's junior mortgage bonds (Refunding and Generals maturing without being extended under the Plan from 1995 to 2000, in which Petitioners Crozier, et al., are interested), as well as the unsecured portion of the interest on the First Mortgage 5% bonds and on the Southwestern bonds, contingent as to time of payment upon earnings, but nevertheless fully cumulative.

(4) The extension of Respondent's unsecured bonds (Convertibles, in which Petitioners Phillips, et al., are interested) from February 1, 1960 to February 1, 2010, with interest contingent as to time of payment upon earnings, but nevertheless fully cumulative.

(5) The allocation of the major portion of future earnings to a Capital Fund, a General Sinking Fund, and a Surplus Income Sinking Fund, thereby depriving Respondent's stockholders of the possibility of sharing in future net earnings to the extent of the first $3,500,000 (approximately) per year, and then only to the extent of 25% of the remaining balance,[5] if indeed there be any remaining balance.

(6) The freezing against dividend payments of a corporate surplus of approximately $162,000,000, made up of approximately $110,000,000 of appropriated and approximately $52,000,000 of earned surplus (PX1; RX31).

(7) The cancellation of $3,682,650 of treasury bonds.

Questions Presented

The two petitions herein present but four questions. The petition of Crozier, et al., is addressed only to the first of these questions, which are:

[5]The figure of $3,500,000 is an absolute minimum and does not include the full amount presently payable into the Surplus Income Sinking Fund, which at the outset is 50% of annual net earnings after payment of all interest and of the fixed amounts payable into the Capital and General Sinking Funds. Cf. *infra*, p. 17, n. 10. The Surplus Income Sinking Fund payment need not exceed $750,000 per annum when and as Respondent's annual charges for interest and guaranteed dividends are reduced below $22,000,000. If and when such annual charges are reduced to $20,000,000—a reduction of approximately $5,800,000, equivalent to a debt reduction of over $100,000,000—the provision requiring the payment into the Surplus Income Sinking Fund of an amount equal to any dividend is not operative unless and until such charges are subsequently increased to an amount in excess of that figure.

1. Both of the Petitioners claim that the decision of the court below, approving and confirming the Plan, is violative of the "strict priority" rule. Petitioner Phillips' claim on this score is in substance that the Plan provides no "compensation", or, in the words of the Statute, "fair consideration", to the holders of Convertible bonds for the adjustments therein accomplished by the Plan. Petitioner Crozier makes similar claim as to holders of Refunding bonds but argues, further, that as to such holders the court below went beyond its jurisdiction under Chapter XV in approving the provision of the Plan for "the removal of any and all existing restrictions upon the extension, renewal or refunding of bonds * * * or any other debt * * * secured by lien senior to that of the Refunding Mortgage".

2. Petitioner Phillips claims that the court below held "that the jurisdictional requirement that the petition be filed in 'good faith' meant merely that there must not be 'intentional fraud' ";[6] that RFC's refusal to extend Respondent's matured debt was collusive and amounted to bad faith; and that, hence, Respondent was unable to support the necessary allegation of its petition to the court below that it was "unable to meet its debts matured or about to mature".

3. Petitioner Phillips claims that Respondent's 1944 maturities could have been met through the application of working capital augmented by funds from the sale of system collateral securing such maturities, and that, hence, Respondent did not sustain its averment that it

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[6]The court did not so hold. Cf. *infra*, pp. 20-21.

was "unable to meet its debts matured or about to mature".

4. Petitioner Phillips claims that Respondent did not sustain the burden of proving the acceptance of the Plan by affected creditors as required by Sec. 725 (2), and, further, that it induced acceptance by misrepresentation "as to the obligation of the bonds".

Summary Of Argument

1. The Petitions Present No Question Which Should Be Reviewed By This Court.

This is a proceeding, jurisdiction of which was created in the court below by an Act of Congress which has expired by its terms. No other proceeding under that expired Act is pending in any court of the United States.

The decision of the court below is in complete accord with the doctrine of "strict priority" established and reiterated by this Court. The petitions for certiorari disclose that the only "strict priority" question sought to be raised by Petitioners is whether the Plan provides "fair consideration" to the holders of Convertible and Refunding bonds. That it does is readily demonstrable.

The questions as to Respondent's "good faith", its ability to "meet its debts, matured and about to mature" and its establishment of acceptance of the Plan are largely, if not entirely, questions as to the weight and sufficiency of the evidence. Only by adroit phraseology in the Phillips petition have they been given semblance of questions of substantive law. This Court should not be asked to review evidence taken before, and considered and passed upon at first hand by, a specially constituted District Court of three

judges. Moreover, in this case the facts were largely considered and passed upon by an administrative agency charged by law with protection of the public interest which to a great extent is concerned with and will be furthered by consummation of the Plan of Adjustment approved and confirmed by the Decree of the court below.

2. The Plan Is Fair And Equitable As An Adjustment And As Such Will: (a) Afford Due Recognition To The Rights Of Each Class Of Creditors And Stockholders And Fair Consideration To Each Class Adversely Affected And (b) Will Conform To The Law Of The Land Regarding The Participation Of The Various Classes Of Creditors And Stockholders.

The Plan conforms to the "strict priority" rule laid down by this Court.

> "The adjustments provided in the plan are in accord with the priorities of the several classes of claims and the extent to which they will be benefited by a financial adjustment." 261 ICC 51, 88 (R. 65).
>
> "* * * a study of the main features of the present plan, and its particular impact on the several classes of affected securities, leads us to the conclusion that the plan as a whole is fair and equitable." 63 F. Supp. 542, 551.

The court below tested the Plan in the light of each of the statutory requirements. 63 F. Supp. 542, 550-565.

3. The Plan And The Acceptance Thereof Are In Good Faith And Were Not Made Or Procured By Any Means, Promises, Or Acts Forbidden By The Bankruptcy Act.

The court below judged Petitioner Phillips' charge of bad faith according to the standard called for by the nature of the charge and its alleged basis. The charge was that

the Plan was a "collusive management plan" (Phillips petition, p. 23). As to Respondent's averred inability to meet its debts, matured or about to mature, the charge was that it was "the result of inspiration and collusion [between the RFC and] officers and directors of the Railroad to create an only simulated or 'synthetic' financial embarrassment for the purposes of this case". 63 F. Supp. 542, 557.

As the court below quite correctly characterized it, this was a charge of "intentional fraud".[7] 63 F. Supp. 542, 557, n. 16.

4. Respondent Was Unable To Meet Its Debts, Matured Or About To Mature, Otherwise Than By Procuring Their Extension.

Whether Respondent was able or unable to meet its debts, matured or about to mature, was largely a question of fact. As to that, certainly this Court will not permit certiorari to be used to secure a review of evidence.

That the issue of Respondent's inability to meet its debts presents no question of statutory construction is abundantly evident.

5. The Plan Has Been Accepted By Or On Behalf Of Creditors Affected Thereby Holding More Than Three-Fourths Of The Aggregate Amount Of The Claims Affected Thereby, Including At Least Three-Fifths Of The Aggregate Amount Of The Claims Of Each Affected Class.

The evidence of acceptance of the Plan was presented in the form of the original duly executed contracts of acceptance signed by the bondholders. No evidence even tending

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[7]Statements in the Phillips petition that the court below limited the meaning of the words "good faith" as used in the Act to "absence of intentional fraud" are incorrect. Cf. pp. 20-21, *infra*.

to indicate invalidity of any one of the agreements of acceptance was offered for the consideration of the court below, although Petitioner Phillips was given repeated opportunities to make such offer. In any event, there is nothing involved in this question as presented by Petitioner Phillips other than a review of evidence and particularly of inferences that he would have this Court draw from the evidence.

The charge of "misrepresentation" in the procurement of the agreements of acceptance is frivolous.

6. Early Disposition Of This Cause Is In The Public Interest And In The Interest Of Each Class Of Creditors And Stockholders.

Many thousands of bondholders are waiting to exchange the bonds they now hold for the better bonds which they will receive pursuant to the Plan.

Only consummation of the Plan is delaying refunding operations, which are essential in the public interest and in the best interests of Respondent's Refunding and Convertible bondholders. To prevent, delay or make refunding operations more cumbersome, as Petitioners Crozier, et al., would do, would be contrary to their own best interests.

Argument

1. The Petitions Present No Question Which Should Be Reviewed By This Court.

A—The statute, in the application of which the court below is alleged to have "decided an important question of federal law which has not been, but should be, settled by this court," has expired by its terms.

Counsel for Petitioner Phillips tell this Court (p. 6 of their petition) that "the provisions of Chapter XV have expired except in respect of proceedings initiated before November 1, 1945." They do not tell this Court, as is the fact, that the instant proceeding is the only one initiated before November 1, 1945 in which the decree approving and confirming the Plan has not become final. Counsel for Petitioner Phillips tell this Court (p. 6 and note 7 of their petition) that "legislation to extend its provisions has passed the House of Representatives and is pending in the Senate of the United States" and that "a somewhat different bill (S. 1253, 79th Cong. 2d Sess.) * * * was reported favorably to the Senate." Counsel then suggest that final passage of S. 1253:

> "* * * would remove from Section 77 and place under the new procedure—*basically similar to Chapter XV*—pending 77 proceedings of certain major railroads including the Denver and Rio Grande, The New Haven, and Missouri Pacific among others" (p. 6, n. 7 of Phillips petition; italics ours).

Finally, counsel for Petitioner Phillips tell this Court (p. 35 of their petition) that:

> "A clear declaration by this Court of the necessity for unmistakable, non-colorable proof of inability to meet debts matured or about to mature is essential to proper administration of the law and to firm insistence by the courts upon the sanctity of corporate obligations in accordance with law and our constitutional system."

Counsel for Petitioner Phillips do not tell this Court that should S. 1253, as favorably reported by the Senate Com-

mittee on Interstate Commerce, become law, no issue could conceivably be raised as to whether a carrier seeking to avail itself of its benefits might or might not otherwise be "unable to meet its debts, matured or about to mature." Neither the quoted words nor others of similar purport are in the bill.

B—It is apparent from the petitions herein and from the opinion and the Decree of the court below that the decision of the court below is not in conflict with the decisions of this Court establishing the rule of strict priority.

To present a question warranting review by this Court it is not sufficient that a case involve somewhat similar facts or entail application of principles enunciated in previous decisions of this Court. Nor is it enough that this Court might possibly have decided the case differently than did the court below. It is required that the decision below be "probably in conflict with applicable decisions of this Court." Counsel for both Petitioners tell this Court that the decision below is in conflict with this Court's decision in the "strict priority" cases, but they have attempted no demonstration of their point save by quotation of broad statements of principle from several of this Court's opinions in such cases. Significantly, counsel for both Petitioners rely in the last instance on the fact as stated by counsel for Petitioner Phillips (p. 14 of their petition) that:

> "Although the attention of the court below was called at length to the requirements of the *Boyd* case and cases which reiterate and apply its doctrine, *the court did not cite or refer to a single precedent* * * *" (italics ours).

C—The remaining "questions" as to "good faith" and proof of the Plan's acceptance by affected creditors involve only the weight and sufficiency of the evidence.

No argument is needed to demonstrate that there can be no warrant for the issuance of a writ of certiorari merely to review evidence or inferences drawn from it. Our analysis hereinafter of Petitioner Phillips' unsupported accusation of fraud and collusion and his claim as to the insufficiency of the evidence of acceptance of the Plan by affected creditors leaves no doubt that his petition seeks to obscure the fact that what he is really seeking is a review by this Court of the evidence and inferences which he would draw from it.

On this score, it should be observed that although Petitioner Phillips appeared, *pro se,* both in the proceeding before the Interstate Commerce Commission and in the hearings before the court below, he offered no direct evidence save his own opinion testimony and certain statistical exhibits and the testimony of a former employee of Respondent who had resigned, as the court below noted in its opinion, "on the eve of the final hearing of this case on September 17, 1945." That witness, who said "he did not question 'the intrinsic soundness of the Plan' " and that he was "not questioning the good faith of any of the officers and directors of the Baltimore and Ohio who became such after the time of the 1938 Plan", expressed the opinion that the Plan was unnecessary and therefore not in good faith, although admittedly that "was based on his own personal view" and, as the court found, "was not supported by the evidence or exhibits in the case" (63 F. Supp. 542, 557, 559).

2. The Plan Is Fair And Equitable As An Adjustment And As Such Will: (a) Afford Due Recognition To The Rights Of Each Class Of Creditors And Stockholders And Fair Consideration To Each Class Adversely Affected And (b) Will Conform To The Law Of The Land Regarding The Participation Of The Various Classes Of Creditors And Stockholders.

There is no question but that Respondent is fully solvent. The further question, whether Respondent's affairs are liquid (as Petitioner Phillips somewhat inconsistently claims) is hereinafter considered. No affected creditor's claim is scaled as to either principal or interest. Incident to the purpose of the Plan—one of its "essential features"—so to extend the maturity of Respondent's "funded debt as to prevent the grouping of maturities within a short space of time" (R. 65), the wholly unsecured Convertibles—presently not maturing until 1960—are extended to 2010, namely, after the maturity of the secured Refundings (1995-2000). Payment of the wholly unsecured interest on the Convertible bonds, amounting annually to $2,785,770, is, like the payment of the unsecured portion of the interest on the First Mortgage 5% bonds and of the unsecured portion of the interest on the Southwestern bonds, amounting in the aggregate to $1,237,547 per annum, made contingent upon earnings. To the extent it may not be fully paid annually it remains an absolute cumulative obligation of the Company. These are the adjustments in the rights of holders of Convertible bonds of which Petitioner Phillips complains.

The maturity of the Refunding bonds is unaffected by the Plan. Their full interest is secured, equally with their principal, by lien (subject to $228,861,050 of prior lien bonds affected by the Plan (PX 92; RX 2240)) on Respon-

dent's property. Payment of 60% of that interest is made contingent (and cumulative) upon annual earnings, but is provided for prior to payment of *unsecured* interest. The restriction of a covenant not to extend the maturity of bonds senior in lien to the Refundings is removed in the interest of flexibility in Respondent's financial structure. This latter provision of the Plan is the adjustment in the rights of holders of Refunding bonds of which Petitioners Crozier, et al., complain.

The sole issue[8] is whether the Plan "as an adjustment" provides "fair consideration" for the adjustments. "Fair consideration" is clearly provided through the stockholders' unqualified undertaking, which binds them for so long as the bonds affected by the Plan remain outstanding (which, as Petitioner Phillips has attempted to impress upon this Court, may be until the Twenty-first Century, in the year 2010), to devote, as an absolute minimum, the first $3,583,-944 of Respondent's annual net earnings to the betterment of the property to which Respondent's creditors must look for payment, as well of interest on and principal of their claims, and to the retirement of debt encumbering that

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[8]At the hearing before the court below, Petitioner Phillips defined the issue thus:

> "* * * my position with respect to this Plan is that * * * I have no objection to a Plan of Readjustment which extends the maturities and places the *junior securities* on a contingent interest basis, provided the stockholders adequately compensate the *Convertible Bonds* for the sacrifices proposed * * *. With respect to the question of whether the Plan is fair and equitable in its treatment of Convertible Bonds, my position is that it unfairly and inequitably preserves the rights of the stockholders at the expense of the Convertible bondholders and that it *offers no compensation whatsoever* for the rights to be surrendered by the latter" (R 1434; italics ours).

property.[9] To Petitioner Phillips, this consideration may not be "susceptible of mathematical demonstration", but to Respondent's stockholders who are contracting to deny themselves access to at least the first $3,583,944 of annual net earnings,[10] it is most definitely "susceptible of mathematical demonstration".

Likewise "susceptible of mathematical demonstration" is the consideration passing from the stockholders in their unqualified relinquishment of any right to have distributed to them as dividends any part of Respondent's admittedly substantial surplus, largely built up through the judicious management of Respondent's affairs since 1941. Both in the court below and in their petitions to this Court Petitioners have chosen to ignore this salient feature of the Plan which not only limits payment of dividends but requires as conditions precedent to such payment that interest be fully paid and that, so long as annual charges exceed $20,000,000, additional payments (equal in amount to any dividends paid) be made into the Surplus Income Sinking Fund. That provision of the Plan further limits the source from which dividends may be paid to accumulations of the

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[9]Petitioner Phillips professes to see a distinction between a Sinking Fund earmarked for a particular issue and one which although "stiff" in amount is nevertheless not earmarked so as to leave the management latitude to accomplish maximum benefits in reduction of charges. Cf. the attempt to distinguish *Delaware and H. R. R. v. Dancey*, 51 F. Supp. 763, at pp. 20-21 of the Phillips petition.

[10]Made up of Capital Fund $1,093,187; General Sinking Fund $1,740,757; Surplus Income Sinking Fund $750,000. For the first year under the Plan the total amount is $10,757,773.45. That amount was allocated pursuant to the Plan out of 1945 earnings, as follows: Capital Fund $3,553,498.18; General Sinking Fund $1,740,757; Surplus Income Sinking Fund $5,463,-518.27. If Respondent's 1944 maturities could have been extended without the conditions imposed by their holder, that money could have been used to pay more than $3 per share on Respondent's common stock in addition to a dividend of $4 on its preferred stock.

excess in annual earnings, beginning with the year 1945, remaining after payment of all interest as well as all amounts required to be paid into the Capital and Sinking Funds (PX 1; RX 16).

Petitioner Phillips and Petitioners Crozier, et al., proposed in the court below that the Plan be modified so as to impose more drastic restrictions on dividend payments. Presumably they thought that if the restrictions were a little more drastic there would be "fair consideration" to the Refundings and the Convertibles. The court considered these proposed modifications very carefully, and in doing so said, in part:

> "Most of the few intervenors in the case propose modifications of the plan with respect to the payment of dividends. In general they urge that more drastic restrictions should be imposed than those contained in the plan.
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> * * *
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> * * * * These restrictions on the payment of dividends are indeed very substantial. For example, if we apply them concretely to a liberal estimate for any one year of $45,000,000 for income available for charges, it is found that the effect of the restrictions will be to leave only $3,000,000 as the *maximum* sum possibly available for dividends on preferred and capital stocks having an aggregate par value of over $300,000,000. On the same estimated net income, without the plan, the sum that would have been available for dividends would be $18,000,000.
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> "Various suggestions have been made for further restrictions on the payment of dividends. *We have considered all of them and have concluded that the restrictions in the plan are amply sufficient for fairness of treatment of the Railroad's creditors.*

> As we have previously pointed out, if the Railroad is to remain under private management, the stockholders must have some incentive for good management and as they are one of the classes necessarily affected by the plan, it should be fair to them as well as to the creditors." (Italics in this paragraph ours.) 63 F. Supp. 542, 565-7.

Additional consideration, likewise "susceptible of mathematical demonstration", as admitted by Petitioner Phillips, lies in the provision of the Plan for the cancellation of $3,682,650 principal amount (including $267,000 principal amount of Convertible bonds) of bonds of issues affected by the Plan, now held in the Respondent's treasury, and which but for the Plan could be reissued.

Finally, because of the conversion privilege which attaches to both the Convertible bonds[11] and the Refunding bonds, and to no other class of Respondent's funded debt obligations, holders of the Convertible bonds and the Refunding bonds may at any time realize to the fullest extent on any advantage accruing to the stockholders by virtue of the Plan.

Because of the Plan, so long as the bondholders do not receive their current due, the stockholders can get nothing; whatever increase in value may ultimately accrue to the stockholders, the Convertible bondholders may share in, *pari passu*.

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[11]The privilege of conversion is extended by the Plan throughout the extended life of the Convertible bonds and this, even without the other benefits of the Plan, is consideration newly moving to them. The conversion rate is 10 shares of common stock for one $1000 Convertible bond—par for par. Petitioner Phillips would view the conversion privilege as "compensation" if the rate were made 40 shares of common stock for one $1000 Convertible bond (R. 1510). Obviously, then, his question is not whether there is "compensation", but, rather, "how much".

3. The Plan And The Acceptance Thereof Are In Good Faith And Were Not Made Or Procured By Any Means, Promises, Or Acts Forbidden By The Bankruptcy Act.

The conclusion of the court below that the Plan and its acceptance are in good faith and were not made or procured by any means, promises, or acts forbidden by the Bankruptcy Act, was reached on a record reflecting the most searching inquiry. The opinion below gives evidence not only of the court's meticulous consideration of every representation made to it in that regard, but also that the charge of bad faith, which is the sum and substance of the Phillips petition, is utterly baseless. In concluding a four page discussion of the subject, the court below said of Petitioner Phillips' witness:

> "We have carefully considered the whole of his testimony. * * * his expressed opinion that the plan was unnecessary and therefore not in good faith, was based on his own personal view and was not supported by the evidence or exhibits in the case" (63 F. Supp. 542, 559).

In considering this aspect of the Phillips petition we cannot ignore its misstatement of the "standard" followed by the court below in considering the "good faith" question. The petition represents (p. 22) that the court below reached its decision on the erroneous "assumption that lack of good faith could be established only by a showing of 'intentional fraud' ". At page 26, the petition states that the court below was "misled by its view that 'good faith' was established unless an objector showed 'intentional fraud' ". Finally, at page 29, the petition states "the court erroneously applied to the facts the sole standard of 'intentional fraud' ".

As its opinion clearly shows, the court below was meticulous in its consideration of Petitioner Phillips' charge of "bad faith". Actually what the court below said was that "the principal attack on the plan" was the "charge that it is not proposed in good faith" (63 F. Supp. 542, 557). In a marginal note the court observed that the "good faith" requirement, appearing throughout the Bankruptcy Act and not merely in Chapter XV, had "received a judicial construction which is broader than intentional fraud". But, the court further observed, characterizing the basis for the Phillips' attack, that "in this case the phrase lack of 'good faith' is used in its primary sense of intentional fraud". And this characterization of Petitioner Phillips' attack was quite correct. For he based his charge, as the most cursory examination of the record would show, on the alleged existence of "collusion" between Respondent's officers and officers of the RFC; he alleged that there had been a secret agreement—a "gentlemen's understanding"—in 1938 to extend the 1944 maturities at the appropriate time and that RFC's subsequent refusal to extend was only "simulated"; that it refused to extend at the behest of Respondent's officers, incident to a conspiracy fraudulently to create jurisdiction of the Plan in the court below. These charges failed utterly of support.

4. Respondent Was Unable To Meet Its Debts, Matured Or About To Mature, Otherwise Than By Procuring Their Extension.

The record and the opinion of the court below establish conclusively, as a matter of fact, Respondent's inability to meet in full the $113,000,000 of its funded debt which matured in 1944. Respondent's officers explored every avenue

of credit open to a railroad in the normal course of business, without avail. While its cash working capital was at the time in a satisfactory condition from an operating standpoint, it could not safely[12] use it to accomplish more than the approximately $29,000,000 reduction which was effected.

The statement that "the court's finding of the Company's inability to pay debts * * * amounts merely to a finding that it was inadvisable for the Company to do so", begs the very question which the petition is designed to raise. That statement is directed to the court's refusal, in effect, to direct Respondent to sacrifice its investment in securities "of the utmost importance to the integrity of the B and O System"; holdings "highly important as the basis for important railroad operating arrangements between the B and O and the Western Maryland and Reading Railroads, and the Southern Railway" (63 F. Supp. 542, 560).

Petitioner offered no evidence even suggesting that the sale of the securities in question would have raised a sum

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[12]The Phillips petition attempts to read a sinister purpose into Respondent's husbanding of its cash working capital. Such an imputation, of course, discloses lack of understanding of fundamentals of railroad finance. The wisdom of Respondent's management has already been forcibly demonstrated by current developments of which this Court must be only too well aware. The record shows that as early as the forepart of the month of March, 1946 the situation into which the national economy had developed had resulted in Respondent's cash intake of less than $8,000,000 in an eight-day period during which its outgo was in excess of $17,000,000 (R. 1903).

But for a reasonable cash working capital position Respondent could not have withstood the impact of the 1946 shut-downs in the automobile, steel, coal and other industries, plus a substantial retroactive wage increase for which there has been as yet no compensating increase in freight rates.

sufficient, with other funds which he charged were available, to avoid necessity for the Plan and this proceeding. As to the Reading and Western Maryland stocks, the record does show contemporary market prices. But it cannot be seriously suggested that current market prices of securities issues, of which only relatively small portions are available for public trading, can be taken to indicate the price which could be realized upon sale of substantial portions of such issues theretofore not available in the market. Or that the sale of such securities might not lead the investing public to believe that the bases for profitable operations theretofore in existence were about to be severed.

In the last analysis, as the court below pointed out, assuming the question of statutory construction to be presented, it is inconceivable that the Congress could have intended to precipitate consequences which it was the Congress' avowed purpose to avoid. This Court has clearly defined the policy governing the question. As the court below said, giving effect to that policy:

> "A serious threat of the sale of these items of collateral would almost inevitably necessitate a drastic reorganization proceeding under section 77 of the Bankruptcy Act to preserve if possible the integrity of the B and O System. See Continental Illinois Nat. Bank & Trust Co. v. Chicago, Rock Island & P. R. Co., 294 U.S. 648, 55 S.Ct. 595, 79 L. Ed. 1110. It is the very purpose of this present proceeding to avoid this disaster which would certainly cause great loss to the holders of securities affected by the present plan.
>
> "Looking at the broad and beneficial purpose of Chapter XV, we think the condition therein that the Railroad must show its inability to pay its debts as

they mature should not be so narrowly and strictly construed as to deny approval of the petition in this case on the possibility that the R. C. F. [sic.] could realize on its loan by sale of collateral which might so seriously affect the integrity of the B and O System as a going concern. * * * This purpose would be defeated if such a railroad could not take advantage of the Act without disposing of collateral that would greatly impair its usefulness and efficiency as a going concern" (63 F. Supp. 542, 560).

5. The Plan Has Been Accepted By Or On Behalf Of Creditors Affected Thereby Holding More Than Three-Fourths Of The Aggregate Amount Of The Claims Affected Thereby, Including At Least Three-Fifths Of The Aggregate Amount Of The Claims Of Each Affected Class.

Evidence of due acceptance of the Plan was presented to the court below in the only way in which, due regard for the rules of evidence being had, it could properly be presented. Petitioner's Exhibit 100, offered and received in the court below, consists of approximately 39,000 individual agreements to accept the Plan, each duly executed by or on behalf of a holder of bonds of one or more of the issues affected by the Plan. The original agreements, not copies, have been sent to and are now in the office of the Clerk of this Court by order of the court below.

No offer of evidence tending to prove the invalidity of any one of such agreements was made (despite numerous opportunities accorded Petitioner Phillips in the course of the 5-day hearing on the merits) until the hearing on the form of the Decree—six months after the conclusion of the hearing on the merits of the Plan, and four months after the opinion of the court below was filed. That offer is quite properly characterized in the footnote to page 1 of the Phillips petition as an offer of proof of "representa-

tion". That Petitioner Phillips may be "attorney-in-fact" for the owners of certain bonds affected by the Plan—a fact not proven of record in this proceeding[13]—is completely immaterial to the question of the weight and sufficiency of Respondent's evidence of acceptance of the Plan as required by the Statute.

What the record shows, and the court below quite properly decided this issue on the evidence before it, is that the Plan was accepted by 99.74% of the affected creditors acting on it. Those creditors held 99.90% of the voted claims. (PX102; RX 2262)

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[13]The court below found with respect to the participation, solicitation, and alleged representation of others by Randolph Phillips:

> "Prior to said hearing [September 17-21, 1945] and on April 17, 1945, Randolph Phillips, who participated in person at said hearing as the owner of a one-third beneficial interest in $100,000 principal amount of said Convertible bonds (Class 8), became registered as the owner of a $1,000 principal amount Convertible bond (Class 8). Thereafter by communications dated April 19, 1945, May 28, 1945, and August 1, 1945, all addressed and circulated to the holders of said Convertible bonds, Randolph Phillips advised such holders not to accept the Plan and solicited from such holders (a) written authorizations to represent them in connection with the Plan, (b) written revocations of assents to and acceptances of the Plan, and (c) writings imposing conditions on assents to and acceptances of the Plan. No such authorizations, revocations, or writings were offered in evidence at said hearing. Evidence purporting to show that Randolph Phillips was possessed of authorizations to represent $2,400,000 of convertible bonds (Class 8) was offered by him at the hearing set to consider objections to the decree and supplemental indentures held on March 12, 1946; but the evidence was rejected as coming too late since full opportunity to offer such evidence had been afforded to all parties at the hearing held September 17 to September 21, 1945" (Decree, Article I(6); R. 1945-6, cf. R. 1943).

The charge of "misrepresentation" in the procurement of the agreements of acceptance is frivolous. Solicitation of the bondholders was necessarily carried forward in accordance with applicable rules promulgated by the Securities and Exchange Commission and solicitation material was, of course, reviewed by the Securities and Exchange Commission currently. That Commission is not complaining.

6. Early Disposition Of This Cause Is In The Public Interest And In The Interest Of Each Class Of Respondent's Creditors And Stockholders.

Many thousands of bondholders are waiting to exchange the bonds they now hold for the better bonds which they will receive, pursuant to the Plan, to evidence the modifications approved by the Decree.

In its "no compensation" argument the Phillips petition attempts to refute our assertion that the Plan offered each affected bondholder a better bond than that he held, and to create the illusion that the Decree is violative of the "strict priority" rule. The Phillips petition attempts this by referring to the bonds offered in exchange as "inferior securities" (p. 14), and states that "at the very least, the plan destroys the strategic position of the Convertibles" (p. 17).

The fact is that recognized financial services have rated the new bonds as "better bonds" than those for which they were offered in exchange (Cf. PX 98; RX 2254 and PX98A; RX2256). And such improved rating necessarily enhances their market value (R. 720-725). In the course of the hearing on the merits of the Plan, Petitioner Phillips attempted to support his suggestion that the Convertible bondholders would lose their "strategic position"

by a statistical exhibit purporting to illustrate the effect of the Plan on the interest "coverage" of the Convertible bonds. That statistical statement (OX 25; RX 3478) proceeded on the assumption that the Company's annual earnings experience of the twenty-four year period 1921-1944 would be repeated in the twenty-four year period 1945-1968. Of course, the statement as presented showed an impairment in the earnings coverage position of the Convertible bonds because it contemplated payments of substantial amounts into the Capital and Sinking Funds ahead of the payment of Convertible bond interest, but assumed the complete sterilization of those funds and ignored the necessary effect of such payments. That, in fact, the Capital and Sinking Funds will provide the complete salvation of the Convertible bonds is demonstrated in Appendix A hereto. Appendix A further assumes that during the putative twenty-four year period Respondent's stockholders would receive the maximum dividends distributable to them under the restrictive provisions of the Plan. Appendix A demonstrates conclusively that even on Petitioner Phillips' theory, the Convertible bondholders are, through the Plan, offered "superior securities" and a bulwark for their "strategic position".

In conclusion, it must be observed that the net effect of Petitioners' efforts to hinder and delay consummation of the Plan which is clearly in the best interests of each class of Respondent's creditors, can only be productive of detriment to those creditors. Only consummation of the Plan stands in the way of refunding operations,[14] otherwise im-

[14]The Convertible and Refunding bondholders are especially interested, and immediately so, in the Company's ability successfully to perform refunding operations, in any event. But for the Plan, the maturity of approximately $144,000,000 of First Mortgage bonds would now be a scant two years in the future.

mediately available. By such operations alone, Respondent's interest charges can be reduced to a figure well within its historical low limit of earnings. Such refunding operations would further increase the interest coverage of all Respondent's funded debt obligations and redound particularly to the benefit of the junior mortgage debt (the Refunding bonds) and the unsecured Convertible bonds.

Conclusion

It is clear that neither of the petitions has stated a case for review by this Court, and both should, therefore, be denied.

Respectfully submitted,

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